

**HANDBOOK FOR  
CONDOMINIUM ASSOCIATION  
MANAGEMENT**

**VOLUME 2  
FINANCIAL MANAGEMENT & REPORTING  
FOR CONDOMINIUMS**

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## **PREFACE**

### **TERMS TO BE FAMILIAR WITH BEFORE READING THE FOLLOWING MANUAL:**

Accounts - Accounts are used to classify and record financial information in a way that is meaningful to the association, and auditors. A Chart of Accounts is a list of the accounts (categories) used and their corresponding unique codes or account numbers, which usually identify the fund and the account (i.e., operating fund, insurance account).

Journals - Journals are books of original entry. They are a record of daily transactions and are typically maintained for cash receipts, cash disbursements and payroll.

General Ledger - Ledgers are records which break down revenues and expenses over time into accounts. Usually journal entry summaries are posted to the general ledger on a monthly basis. The General Ledger is considered a book of final entry.

Trial Balance - To make sure the sum of debit balances equals the sum of credit balances each month, a trial balance is taken at the end of each month. In order to achieve the balance, missing or incorrect entries are identified and corrected.

Financial Reporting - A system of indicators that reflect the organization's financial condition at a fixed date.

We can differentiate between the internal and external reporting depending upon the information consumers.

Internal Reporting (IR) - Total combination of indicators that characterize separate aspects of the partnership activity, its development in general, compared to the previous period or the budget, etc. The internal reports enable analysis of the financial status and facilitate financial decisions. The forms and types of internal reports developed by the organization itself.

External Reporting (ER) - It is usually set by the legislation and is obligatory for everybody. The external reports describe the organization condition as a whole. It is targeted at the control over tax and collection payment and statistic observation.

Audit Statement - Auditor's report about the audit results. As stipulated by the contract obligations, the auditor states his/her opinion about whether the recordkeeping is correct and reports are properly prepared, whether the original documents are formed in full and properly, about effectiveness of the internal control system, etc. and presents the recommendations for the audit subject.

## **FINANCIAL MANAGEMENT & REPORTING FOR CONDOMINIUMS**

Successful financial management of the condominium association is its lifeline. A realistic financial plan and budget, along with timely and accurate financial recordkeeping are important to the well-being of the association. Without these elements, there will be no assurances that income will be sufficient to meet expenses or that the projected expenses will accurately reflect the work required to maintain and enhance the property.

Equally important to the types of information collected and utilized, is the overall approach to the oversight of finances. Those responsible for working with financial records and controlling financial decisions must be beyond reproach in how they handle their responsibilities. This responsibility occurs at two basic levels. First, there are the individuals who are directly involved with day to day collection and recording of financial information. These individuals must comply with a series of universally accepted principles of accounting. Secondly, there will be those individuals who are responsible for review and oversight of the financial information (typically the Condominium Board). This group has an obligation to address all financial concerns with total integrity; it is their “fiduciary responsibility” to ensure that all financial transactions are occurring in the best interest of the condominium association and that the financial records and resulting reports fully and accurately disclose all financial activity.

This handbook addresses two of the three major components of financial management: fiduciary responsibility and oversight, and financial recordkeeping (accounting) in detail. It also provides a brief overview of financial planning and budget preparation in Appendix A. For further detail on this topic, please refer to Volume 1: Financial Plan Preparation.

### **I. FIDUCIARY RESPONSIBILITIES**

Fiduciary responsibility refers to the obligation of the Board Members and others entrusted with financial management tasks to handle those tasks with integrity at all times. There is both a legal and moral responsibility incumbent on these individuals. Board Members are elected to act on behalf of the overall interests of the condominium association. This is their sole mandate. Board Members do not have the right to make decisions which financially benefit themselves or a select group of owners. In addition to the limitations on the actions of Board Members as delineated in the Condominium Documents, there are legal safeguards which protect against financial mismanagement by the Board (?). The requirement that all Associations appoint an audit committee is a further safeguard against malfeasance on the part of Board Members. Finally, the

utilization of an outside independent auditor serves a number of purposes including detection of fraudulent activity or mismanagement of funds, by the Board or others with access to financial records and information.

In summary, if the following conditions are being met, one can be confident that the oversight of the finances of the condominium association is being conducted in a responsible manner and that Board decisions are being made in the best interest of the common good of all unit owners:

- Financial decisions do not benefit special interest groups to the detriment of the Association as a whole;
- There are no financial benefits which accrue to Board Members as a result of their decisions;
- Board Members comply with the requirements of the condominium documents in regard to financial decision-making;
- An audit committee is appointed, reviews financial records and reports to the General Meeting as required;
- A professional independent auditor is engaged on an annual basis and conducts a review of all financial activities of the Condominium Association;
- Financial reports are readily available for owners to review upon request.

Upholding one's fiduciary responsibility is not, in and of itself, sufficient to guarantee the success of the financial operation of a condominium association. There must be a sound financial management system in place. Unless, the Board can fully rely on the accuracy of the financial information provided to them, there is no certainty that the decisions that they are making are in fact, in the best interest of the condominium association. The following section describes what a financial management system is and the key elements in designing and implementing a successful financial management system.

## **II. FINANCIAL MANAGEMENT SYSTEMS**

Timely, comprehensive, and accurate financial reporting must be a priority for all businesses which have to make decisions related to income and expenses. A condominium association, is in fact, a business operation and can therefore not operate unless all financial information is readily accessible and accurate. Reports provide the

condominium association with the information necessary to determine whether or not their current operation is viable and if there are problems, what corrections need to be made in the short term and in the long term to put the condominium association back on course. Financial reports should also serve as a planning tool to assist the condominium association in making decisions regarding the future maintenance and administrative operations.

## **A. STEPS IN THE FINANCIAL MANAGEMENT PROCESS**

Regardless of the mechanics of a specific financial management system or who has the actual responsibility for recording and reporting information, there are six steps in the financial management process:

### **1. Develop the Budget**

The budget is a projection of income and expenses for the upcoming year. It is the controlling document against which all financial activity is measured.

### **2. Create the Transactions**

When money is received or a check is written, a financial transaction is created to identify the occurrence. Source documents show that a transaction has taken place.

### **3. Classify the Transactions**

Accounts are established to identify the purposes of type of revenue received and expenditure made. A chart of accounts is used to code source documents and classify financial transactions.

### **4. Record the Transactions**

After creating and classifying the transactions, each transaction is recorded in a cash receipts or cash disbursements journal to create a financial record. In essence, journals are diaries of financial transactions.

### **5. Summarize and Reconcile Transactions**

On a monthly basis, prepare a report on the financial results of the time period. Included in the report are revenues received and expenditures made by category; monies payable to the association and monies owed by the

association; available cash balances and a comparison of actual revenues and expenditures to those budgeted for the same time period and for the year.

Reconcile all accounts and make adjustments or corrections as necessary.

## **6. Report and Interpret Information**

Use the information generated to issue reports which describe and evaluate actual results against those anticipated. Based on the evaluation, make management decisions to implement corrective actions and/or revise expectations.

## **B. DESIGNING A FINANCIAL MANAGEMENT SYSTEM**

### **1. Deciding What Types of Information You Need**

The overall objective of a condominium association is to provide a comfortable, positive living environment for all owners; to maintain the property and enhance the environment and the value of the property over time. In order for this scenario to be realistic, there must be sufficient income to meet the current and projected expenses of the property. Therefore, the financial information you generate must be able to assist you in:

- monitoring the current financial condition of your property;
- making operating decisions regarding the property over the next year.

In addition, in order to meet regulatory and legal requirements, a condominium association may be required to file specified reports. In this case, the information you generate needs to be sufficient to satisfy reporting requirements.

### **2. Deciding Who Will Be Involved**

A number of individuals will likely be involved in financial management:

- a. Board Members - As was discussed earlier, the Board will typically receive and review financial reports, make decisions based on this information, prepare budgets and oversee the financial management operation. In the Model Charter, it discusses the role of the Board Member serving as Treasurer. The Treasurer shall be responsible for Owners' Association funds and securities, for keeping financial records, books of account and balance sheets, for the preparation of all required financial data, for deposit of funds and shall, in general, perform all the

duties incident to the office of treasurer of a legal entity such as the Owners Association. The activities of the Treasurer shall be carried out in cooperation with and under the review of the Auditing Committee or the Auditor. As is the case with most Board functions, this responsibility can be delegated to a third party as voted on by the Board.

- b. The Audit Committee - In accord with the condominium documents, the Association will appoint an Audit Committee or an Auditor. The procedures and responsibilities are detailed in the Model Charter as follows "The General Assembly shall either elect an auditing committee from among the Owners or their representatives or appoint an Auditor, to review the annual financial statements, balance sheets, and financial books and accounts of the Owners Association and to oversee the financial activities of the Board of Directors and the Property Manager. The Auditing Committee shall report on the financial status of the Owners' Association within sixty days after the end of each fiscal year, at the Annual Meeting of the General Assembly." It is anticipated that the process for appointing an Auditor would be to have the Board will responsibility for selecting the final candidate/s (see section on Selecting an Auditor) and present the candidate/s to the General Assembly for a final vote.
- c. Staff - The staffing used for financial recordkeeping and management will vary among Associations. Some Associations will self-manage and the Board Members will be the staff. Under this model, the function of the audit committee is extremely important since the Board cannot possibly be viewed as an overseer since it has day-to-day line responsibilities for handling the financial transactions. Another model is that of third-party contract management, where the Board hires a professional property management company to handle one or more management functions including financial recordkeeping and reporting. In this model, it is important that prior to hiring the company, the Board assures itself that the contractor has adequate expertise, has a system in place for internal controls and understands that they are responsible for providing complete financial reports to the Board on an agreed-upon schedule. The oversight role of the Board is critical. If the reports are not prepared on time, do not provide sufficient information for the Board to be certain that funds are being handled properly or are prepared in a format that does not enable the Board to readily analyze the financial status of the association, it is the right and fiduciary obligation of the Board to require that these conditions be met. Because not all Board Members may be familiar with the details of financial recordkeeping, they may be intimidated by a "professional." This should not happen. The Board must always remember that the professional is there solely to serve the purposes of

the association and the Board which represents that association. It is possible that the Board may hire one of its owners to perform the financial recordkeeping function. If this is the case, the owner should be paid and the relationship must be handled as an arms length business relationship. For the purposes of this manual, the term staff includes an owner performing these functions as well as an outsider.

- d. Owners - According to current Russian law, the owners must vote to approve the proposed budget. The Audit Committee is also elected by the owners. In addition, all owners have the right to review financial reports upon request. The Board must remember that they are ultimately accountable to each owner. At the same time, they have been elected to form a representative government. The responsibilities delegated to the Board as representatives include, subject to the budget, primary decision making authority in the area of finance. The Audit Committee has responsibility to monitor and oversee the financial activities.
- e. Auditor - An outside auditor is a professional who provides an independent review of the financial records of a business. As such, he/she cannot have a business relationship with the entity. In the review, the auditor applies a series of standard “tests” to determine whether the records have been properly maintained. The auditor is typically providing a financial and compliance review. The financial review measures the degree to which records have been kept according to accepted accounting principles and whether bookkeeping errors have been made. The compliance component reviews whether or not the business has met the recordkeeping requirements of a lender or relevant government agency.

As is apparent, there are likely to be a number of individuals involved in the financial operation of the condominium association. In designing and implementing the financial system, it is important to determine exactly what role each of the players will have and how the lines of authority and accountability will run.

### **3. Determining Operating Procedures**

The central focus of operating procedures is on the system of Internal Controls. This topic is discussed in its own section which follows next.

### **4. Establishing a Chart of Accounts**



A chart of accounts is used to classify and record financial information in a way that is meaningful to the association, auditors and any relevant regulatory agencies. The actual chart is a list of every account, each one of which has a unique number which typically identifies the fund (i.e., operating or reserve) and the category (i.e., supplies or lift repairs). In designing the system the chart should be limited to those accounts which are likely to be used and should be categorized in enough detail to be meaningful as a management tool.

## **5. Establishing a Filing System**

Written documentation is critical to any recordkeeping system and financial management is no exception. All transactions must be documented. In addition any legal documents or contracts must be kept on file. In establishing a system, files should include the following:

- ▶ Condominium unit files
- ▶ Budget files
- ▶ Monthly Financial Reports
- ▶ Annual Financial Statements
- ▶ Reports to Government, Lenders, Regulatory Agencies
- ▶ Bank Account Information (i.e., account numbers, instructions on signatories)
- ▶ Bank Statements and Reconciliations
- ▶ Cash Receipts
- ▶ Deposit Records
- ▶ Accounts Payable
- ▶ Paid Invoices
- ▶ Copies of Service Contracts

## **6. Creating Journals and Ledgers**

The commonly used journals are for Cash Receipts, Cash Disbursements and Payroll. These are in fact daily diaries of all the transactions in their category. The journals should be maintained regularly. Entries should be explicit and accurate. Neatness counts! The General Ledger is a compilation of all the entries from the individual journals. It is typically maintained and reconciled on a monthly basis.

## **7. Develop Written Policies and Procedures**

Manual

Policies, procedures and controls for the staff, Board and Auditors should be compiled in written form and should be the primary reference for how tasks are performed and who is responsible for each task. The manual should include job description for each person involved in the financial management process. If the Association hires a third party contractor, they should request that they review the company's financial policies and procedures before they finalize their relationship.

### **III. INTERNAL CONTROLS**

Internal Controls refers to the systems put in place to assure that money is recorded, accounted for and expended in accordance with the requirements of the Condominium Association and relevant laws. Internal controls also reduce the likelihood that equipment and supplies will be misappropriated. Internal controls are not a separate system, but an integrated part of systems used to operate any business that is handling money, inventory and/or equipment. Without adequate internal controls, in the best case, innocent and costly errors can be made. In the worst case, individuals can mismanage and misspend millions of dollars.

Without internal controls, money can be stolen, service providers can cheat the Association and mistakes can be made which result in inaccurate financial information being provided to the Board and owners. In establishing an internal control system, the Association should try to meet the following objectives:

1. Safeguard against theft;
2. Make certain that costs billed and paid for services are correct;
3. Provide reliable financial information for budgeting and planning purposes; and,
4. Meet legal obligations of the association.

#### **A. How can the Association Best Meet the Objectives of Internal Controls?**

##### **1. Separation of Duties**

Separate the financial responsibilities so that one person is not responsible for all phases of an activity of transaction.

##### **2. Documentation**

Every transaction should be recorded as it occurs and be properly classified. In addition there should always be written support (i.e., receipts, invoices, deposit records).

### **3. Authorizations**

Written approvals (signatures/co-signatures) should be required for transactions above a specified limit.

### **4. Monitoring and Oversight**

The Board should review financial reports on a monthly basis. The Audit Committee should review selected reports and the financial actions taken by the Board on a regular schedule. An independent auditor should be hired to prepare a financial review on an annual basis.

Although in some cases, it will be difficult to implement a comprehensive system of internal controls because of limited staff and resources, the Association must still insist that all steps be taken to minimize the possibility of errors and dishonesty.

## **B. Which Areas of Condominium Operation are Appropriate for Internal Controls?**

- ▶ revenue (maintenance fees, assessments, subsidy checks)
- ▶ bank accounts
- ▶ receivables (owner delinquencies)
- ▶ disbursements
- ▶ accounts payable
- ▶ payroll
- ▶ capital assets and inventory
- ▶ purchasing
- ▶ service contracts

In analyzing the need for internal controls and which areas are most vulnerable, the association should look at the general attitude of individuals responsible for the given activities, how authority is delegated and how staff and Board Members are held accountable as well as the general business climate in terms of what constitutes “acceptable practices.” In conjunction with this analysis, the inherent risks need to be reviewed. What is likely to be the outcome of a breach in financial management? For condominium associations, the most likely risk is the overall financial health of the organization, which in turn will jeopardize the soundness and viability of the physical systems and facilities. Based on this fact, the choice of safeguards needs to be

evaluated and ensure that they are sufficient to reduce the risk without a disproportionate cost given the level of the risk.

### **C. Examples of Common Internal Control Procedures**

The limiting factors in the use of internal control procedures are likely to be cost and/or availability of staff. The following examples cost virtually nothing. In addition, they can be implemented with as few as two individuals with responsibility for financial management.

- one person orders supplies and a second person receives and processes the invoice;
- one or more Board members sign/co-sign checks;
- one person writes checks and makes deposits and a second person reconciles the statement from the bank;
- one person receives assessments and a second person maintains records and deposit receipts;
- the Board authorizes a limit for spending and any amount over that must receive written approval;
- pre-numbered forms are used;
- financial files are locked;
- current signature cards are kept on file at the bank;
- receipts are issued for all cash received;
- all transactions are recorded as they are executed;
- deposits are made daily;
- if a computer is used, access to financial accounting software is provided by password;
- a log of capital equipment is maintained;
- the approval process for purchases and invoices is in writing and clearly identifies who is authorized to approve and at what point in the process;
- an inventory of supplies is maintained;
- purchases can be made only with pre-numbered purchase order forms;
- Board representative signs off on all financial reports; and,
- an annual audit is conducted by an independent auditor.

An adequate system of internal controls will prevent misappropriation of cash and other resources and misstatement of available cash due to undetected errors (either intentional or unintentional). It should foster the safeguarding of the condominium association's assets, check the accuracy and reliability of accounting data, and promote an efficient financial management operation.

#### IV. FINANCIAL RecordkeepING (ACCOUNTING)

The professional discipline of Accounting encompasses an entire field of knowledge and expertise. Individuals attend University for several years to receive a degree in accounting and must continue further in their studies in order to be certified as an independent auditor. Clearly, it is not possible nor is it necessary for Board Members or individual condominium owners to be accounting experts. What is beneficial is that Board Members have a sufficient understanding of the fundamental components of financial recordkeeping that they are capable of reviewing financial reports, identifying items which require explanation, asking the “right” questions and holding accountable the people to whom they have delegated the responsibility for financial recordkeeping.

We have previously discussed key elements of a financial management system. The following information provides additional details on the key components of the financial recordkeeping process.

Basically, financial recordkeeping for a condominium association deals with the income and the expenses of the association. In terms of income, the primary source of income will be the individual unit assessments payable by all unit owners in accordance with their beneficial interest in the property. Other sources of income may include rental income from commonly owned commercial or residential space, interest earned on Association bank accounts, late fees collected from owners who are delinquent in their payment of assessment and any municipal subsidies. Typically, expenses will include payments for upkeep and maintenance of the property, communal services, professional fees and insurance.

There are two standard systems used for accounting for income and expenses: *cash* accounting and *accrual* accounting. It is important to understand the fundamental difference between the two. Cash accounting assumes that all money that is owed to the condominium is received and that all money owed by the condominium is paid on a regular cycle. If this is in fact the case, a financial report which shows cash received and disbursements made will provide an accurate snapshot of the financial condition of the condominium association and cash accounting is an appropriate method to use. However, because condominium association budgets are not designed to create excess cash and because expenses during the course of the year may vary, even a condominium in good financial health may find itself “strapped” for cash from time to time. Similarly, even responsible owners may find themselves in financial difficulty and be late in paying their monthly assessment. Under this scenario in addition to recording receipts and disbursements, in order to present an accurate financial picture, it is necessary to account for invoices received and fees owed even if neither has been paid. The accrual accounting method reports on receipts and receivables (money owed to the association) and disbursements and payables (invoices received but not paid). If a condominium association typically has unpaid fees and/or unpaid bills, the

accrual method must be used in order to accurately portray the financial condition of the association.

## **A. The Accounting Cycle**

### **1. Cash Receipts**

As stated previously the most common source of income for a condominium association will be the monthly assessments from unit owners. Other possible sources may be rental income from commonly owned property, late fees from delinquent owners and municipal subsidies. The steps in handling cash receipts typically include the following:

- invoicing;
- collecting revenues;
- issuing receipts for cash;
- depositing cash receipts;
- following up on delinquencies;
- making correct account and journal entries.

Good management practices for receiving cash include:

- all receipts are pre-numbered;
- until deposited, cash receipts are kept in a secure place;
- when possible cash receipts should be photocopied and stamped for deposit only;
- the cash receipts should be recorded and reconciled by someone other than the person collecting the cash; and,
- cash receipts should be recorded and deposited in a timely manner.

### **2. Cash Disbursements**

The most likely categories of cash disbursements for condominiums include payment for communal services, supplies, contractors, insurance and payroll. The key steps in disbursements of funds are as follows:

- receiving invoices and other claims for payment;
- verifying the validity of the invoices;
- issuing checks;
- classifying and charging disbursements to proper accounts; and,
- entering disbursements into journals.

Good management practices for disbursing funds include:

- require purchase orders and purchase authorizations for expenditures;
- verify that goods were received;
- determine availability of funds to pay the invoice;
- determine that invoice is not a duplicate;
- check the terms and conditions of any vendor contract;
- make all disbursements by check;
- impose spending authorization limits;
- require dual signatures on checks;
- require that all employees prepare and sign time sheets to support payroll expenses; and,
- set up procedure for payment of recurring expenses that may not provide invoices.

### **3. Month End Closings**

The typical time period for compiling and summarizing financial activity is a monthly cycle. Even when financial reports are not presented on a monthly basis, the cycle is used to reconcile current financial records. However we recommend that reports be prepared and presented to the Board each month so that they are fully informed about the financial condition of the condominium and can take any necessary corrective action before too much time has elapsed.

**This is especially important with respect to collection information. In many cases, an Association will have at least a few owners who are delinquent in their condominium fees. It is much easier to deal with these delinquencies on a monthly basis, rather than quarterly when the amount they owe will have grown four times and will be more difficult for them to pay. Equally important is keeping track of money the Association owes for products and services. A monthly report will allow the Board to see an accurate and timely report of bills to be paid and could result in significant savings by avoiding unnecessary interest fees and penalties.** Steps involved in monthly closings are:

- summarize all journal entries;
- post journal entries to a general ledger;
- run a trial balance;
- reconcile cash balance to bank statements;
- prepare monthly summary of revenue and expenses;
- prepare reporting comparing actual income and expenses to budgeted figures;

### **4. Year End Closings**

The accounting activity that occurs at year end is similar to that which occurs each month. This accounting is usually done or reviewed by the external auditor hired to prepare the Annual Financial Statement.

## **5. Year End Financial Statement**

The year end financial statement will be prepared by the Auditing Committee or by an outside auditor. Using the same closing procedures as occur at the end of each month, the year end statement will include:

- a statement of income and expenses for the year;
- a balance sheet;
- a statement of changes in operating position; and,
- comments on accounting procedures and internal controls (if prepared by an outside auditor).

## **B. Reporting**

Recordkeeping is not a goal unto itself. Rather it is intended to provide information about the condominium association to the Board, individual owners and any outside entities which have a financial stake in the condominium property (for example, a lender who is providing funds for capital improvements or a municipality which is providing a subsidy). It is in effect a management tool which will assist in determining priorities for the maintenance of the physical plant and determining how much income is necessary to provide adequate services to all owners. The basic reports which should be prepared on a monthly basis are listed below with a brief description of their purposes:

### **1. Statement of Receipts**

This report provides information about all the monies received during the month, sorted by category. Categories may include assessments, late fees, rental income (if applicable) and interest income. It informs the Board of how much money is flowing into the condominium association in general and is incorporated as part of a budget comparison report.

### **2. Statement of Receivables**

This report details information about any money owed to the association which has not been paid. Typically, this money represents delinquent assessments. This information is very important so that the Board knows who is not paying on



time and can follow-up to make certain that fees are paid. This statement may include an “aging report” which lists unpaid fees and other monies by date. Monies that are overdue by more than thirty days require more severe action than those which are only overdue a short time.

Without this information, it is difficult to implement a collection policy.

### **3. Disbursements**

This report lists all monies paid out during the course of the reporting period. The name of the payee, a brief description of the services, the amount and date paid are all included. This report provides detail to the Board of payments made.

### **4. Accounts Payable**

This is a listing of all invoices received during the month which are unpaid at the end of the monthly reporting period. The listing includes the name of the vendor, a brief description of services, the amount and due date. It is important for the Board to be aware of unpaid bills in order to understand their total financial obligations at a point in time.

### **5. Bank Statement and Reconciliation**

In the United States, the bank sends a statement of all transactions each month. This statement is reconciled to the cash balances recorded by the association. By providing the Board a copy of the bank’s statement and the report reconciling it to the accounting records, the Board can be assured that the cash is being accurately accounted for and that no misappropriation of funds has occurred.

### **6. Profit & Loss Statement (Budget versus Actuals)**

In many ways, this report is the most important financial management tool. The report is in effect a statement which compares actual revenue and expenses to those projected in several ways. It compares current month revenue and expenses to monthly projections. It compares year-to-date revenue and expenses to year-to-date projections and it itemizes the annual budget projections along with the unexpended budget balance. Careful review of this statement serves several important purposes:

- ▶ Helps to determine whether or not revenue estimates are accurate, and in which category revenue may have been over or underestimated;

- ▶ Provides a concise picture of expenditures and how they compare in total and by category to original estimates;
- ▶ By reviewing monthly, year-to-date and annual budget information provides insight into whether variances are temporary or permanent.

By carefully reviewing the information in this report, the Board can decide whether or not action must be taken to reduce expenses or increase revenue at any point in time before a crisis occurs.

## **V. THE AUDIT**

The Condominium Documents require that the association have the Auditing Committee of an independent auditor prepare a year end financial statement. The following language is found in the Model Charter. "All books and accounts of the Owners' Association shall be subject to an annual audit by the Auditing Committee or an Auditor in accordance with applicable law. Within sixty days after the end of each fiscal year, the Auditing Committee or the Auditor shall prepare a balance sheet, a statement of income and expenses and a general statement of the financial status of the Owners' Association for the preceding year for submission to the General Assembly." There are several important reasons to have an audit performed:

- The audit provides an independent opinion of the accuracy and fairness of the internal presentation of the associations financial position and the results of its operations.
- The audit can assist in pinpointing the key information needed to make managerial decisions.
- The audit can uncover deficiencies and weaknesses in the accounting system and provide suggestions for improvements.
- The audit will keep the Board current on the financial practices of those responsible for handling the financial recordkeeping.
- The results of the audit may strengthen confidence in the association's financial practices and condition which may benefit the association in securing financing from a lender.

### **A. Choosing an Auditor**

In selecting an auditor to prepare a year end financial statement, the Board will want an accounting professional who is familiar with accounting for condominiums or if that is not possible, someone who is at least familiar with real estate. When discussing the audit with prospective accountants, the Board (or the Auditing Committee if they have this responsibility) should discuss the accountant's experience, the fee and the scope of services to be provided. If practical, the Board can develop specifications for performing the audit and provide these specifications to selected accountant applicants. In this way, the Board can be certain that they are comparing costs for the same scope of services. In the United States, the document used to describe the scope of services which the Auditor will perform is called an "engagement letter." Since there are a variety of activities which can be conducted, resulting in different levels of financial review, the letter is useful to make certain that everyone is clear about what will be done. Since the final choice of Auditor rests with the General Assembly, it is suggested that the Board determine the final candidate/s and present them to the Assembly for the vote.

## **B. Facilitating the Audit**

There are a number of steps that an association can take to simplify the audit process and therefore make it less costly. The less of the auditor's time is used, the larger the savings achieved. By making certain that all financial records are maintained and reconciled during the year, it will require much less effort on the part of the auditor to perform a final reconciliation. In addition to the financial records, it is likely that the auditor will need to review the Charter and Bylaws and well as meeting minutes. The association should have this information readily available to the auditor. In addition to this information, the receipts and disbursement journals, general ledger and monthly statements, the auditor will typically need to see the following information:

- banks statements, and deposit slips;
- bank account reconciliations;
- paid invoices for the year;
- unpaid bills;
- records of all accounts and investments including interest earned;
- insurance policies;
- service contracts;
- loan documents, if applicable; and,
- prior year tax filings, if applicable.

## **C. Audit Activities**

During the course of the audit, the auditor will conduct the following activities:

- Determine that there is an “audit trail”; that is that it is possible to trace a transaction from the original source document through the posting to the individual journal to the general ledger to the financial statements and reports;
- Examine the system of internal controls;
- Examine the key accounting documents processed as part of the recordkeeping system;
- Examine the authorization limits for various transactions; and,
- Check to make certain that financial activities of the condominium association are in compliance with their condominium documents and any other applicable laws.

#### **D. Contents of the Annual Financial Statement**

The work product which results from the audit is the annual or year-end financial statement. This statement should include a Statement of Income, Profit & Loss, a Balance Sheet and Comments on Financial Procedures.

##### **1. Statement of Income**

This is a summary of the condominium association's income and expenses for the year. The statement is derived from the monthly trial balances. The statement will show either a profit or deficit for the year. If there is a deficit, it does not mean that the condominium is necessarily in trouble, since it is likely that the condominium started the year with cash from the prior year. Likewise, a “profit” does not mean that the condominium has surplus funds, since additional bills may be received in the next year for services provided in the prior year. The deficit simply means that during the specific year, the association spent more money than it took in. A deficit will require that the Board look carefully at the detail for the year to determine if it will be necessary to raise additional income or reduce expenses in order to remove itself from a deficit position.

##### **2. Balance Sheet**

The Balance Sheet details all assets and liabilities of the association at a point in time. Assets include equipment, fixtures, money owed to the condominium association (receivables), cash in the bank accounts, deposits with utilities, prepaid expenses such as payment for the year for insurance in advance, and the value of inventory such as fuel oil. Liabilities include unpaid bills, prepayments to the association of assessments, outstanding loans and other

debts. The Balance Sheet is a snapshot of the overall financial condition of the property at a specific point in time.

### **3. Management Letter**

As part of his/her work, the auditor should express an opinion on the financial recordkeeping procedures of the condominium association. As discussed above, the auditor will have tested a random sample of financial transactions occurring during the year to ensure that they were properly recorded and documented. The auditor will also review the procedures and internal controls that are used to ensure that the Board can meet its fiduciary responsibilities. Based on this review and the other identified audit activities, the auditor will prepare a letter to the Board indicating any findings that records were not maintained correctly or that certain procedures or controls are either not being complied with or are inherently inadequate.

The association should use any information provided to improve the quality of its financial recordkeeping activities.

## **VI. PRESENTATION OF FINANCIAL REPORTS**

On a monthly basis, the accounting staff/company responsible for financial recordkeeping will be presenting a written financial report to the Board. We have discussed previously the types of information which will be included in that report. As stated earlier in this manual, the staff is accountable to the Board. As such, it is the obligation of the staff to present all information on a timely basis. This information must be accurate and presented in a form that is easy for Board members, as lay people, to understand. From time to time, Board members may have questions which cannot be readily answered. It is the obligation of the staff to determine the answers and report back that information to the Board. Individual owners also have the right to have access to financial information, upon request. It is recommended that the Board and staff agree on a set of procedures to be used to respond to requests from individual owners. The staff should not be in a position to have to spend hours with an individual owner reviewing the same financial information which they have already reviewed with the Board. Typically, the Board will make financial reports available to owners if they request one. If an owner is taking up an inordinate amount of the staff person's time, the staff person should be able to look to the Board for assistance in limiting this situation.

From time to time, the Board may make financial presentations to the General Meeting. It is important for the Board to remember that their power is derived from all owners and

they are accountable to these owners. Board members may be more familiar with the financial information because they have been reviewing it regularly. However, they are still obligated to present the information in as much detail as the owners require. Depending on the financial situation being discussed, it may be beneficial to have the staff responsible for the recordkeeping appear at all meetings, either to handle the presentation or to be available to respond to questions.

The Model Charter requires that the Board provide an audited year end statement to the General Meeting within sixty days after the fiscal year ends. It is suggested that as part of the responsibilities of the Auditor that he or she appear at this meeting, present the year end statement and respond to any questions. This service needs to be negotiated in advance with the Auditor as part of the scope of his/her work.

## **VII. SUMMARY**

The following summarizes some of the key issues in the financial management of condominiums:

- ▶ Sound financial management involves the planning for and control of the use of funds so that the condominium association can best meet the current and future needs of the condominium association and so that there is assurance that the assets are safeguarded and used properly.
- ▶ A system of internal controls must be in place to protect the financial management integrity of the association as well as the assets.
- ▶ The Board members are responsible for monitoring the fiscal health of the Association. They determine the adequacy of internal controls and review and approve all financial reports.
- ▶ No one individual should be responsible for all financial management tasks. Even when there is a limitation regarding staffing, responsibilities need to be segregated and when necessary, an outside consultant employed to insure that there is a separation of responsibilities.
- ▶ Basic accounting records which need to be kept in order to provide necessary financial information to the Association include the following: cash receipts' journal; cash disbursements' journal; and general ledgers.
- ▶ All financial records should be reconciled monthly even if reports are prepared on a less frequent basis. Monthly reconciliation is important in tracking money

owed the Association as well as money the association owes to suppliers, contractors, etc.

- ▶ An audit should be performed annually. The auditor's job is to ensure that financial records are correct and prepared in accord with accepted accounting principles. The audit will also ascertain that the records meet all legal requirements.

## **APPENDIX A    SAMPLE FORMS FOR BOOKKEEPING**

*(Sample Forms for Bookkeeping are included in the Russian version of the Handbook for Condominium Association Management, Volume 2: Financial Management & Reporting for Condominiums.)*



## **APPENDIX B     BUDGETING PREPARATION**

A Homeowner Association budget is a financial plan prepared before each fiscal year begins. It anticipates the cost of operating the association properly during the coming year. The first step in drawing up a budget is to determine the expenditures that must be made during the coming year. Then optional expenditures can be considered, if it appears that surplus income can reasonably be anticipated or that additional income can be generated through fee increases or assessments.

Among all the expenses that a Homeowner Association will have, some can be predicted accurately in advance, while others can only be estimated. Taken together, the budgeted expenses determine how much income the condominium will need to finance its operations during the coming year. This is how the condominium determines the amount of assessments it will need to collect from the owners for that year.

If it is necessary to raise the level of condominium assessments, a well-prepared budget will help explain the need for the increase to the owners. Except in the event of a major catastrophe, assessments should not have to be increased during the year if a detailed and reasonably accurate budget has been prepared. The Homeowner Association budget will help each owner budget for their individual expenses and will give all owners greater confidence in the Board of Directors and the management of the Homeowner Association.

There are two fundamental types of budgets which a condominium association will be working with: operating budgets and capital reserve budgets. The operating budget is the budget which describes the routine and ongoing expenses of the condominium. The budgeting process described above is used in developing this operating budget.

The capital reserve budget describes the expenses associated with major repairs or replacement of capital items such as elevators, heating systems and roofs. The income for the capital budget may have a number of sources. One source should come indirectly from the regular condominium fees; there is an expense line in the operating budget marked capital reserve. The money allocated for this expense is then transferred from the operating bank account and deposited into a separate capital account. Other sources of income for the capital reserve budget may include special assessments or bank loans.

For additional and more detailed information, refer to Volume 1: Budget Preparation.